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INFLUENCE OF DIVIDEND POLICY ON STOCK PERFORMANCE AMONG BANKING SECTOR FIRMS LISTED IN NAIROBI SECURITIES EXCHANGE, KENYA

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ABSTRACT

The Nairobi Securities Exchange, which is an emerging market, shows some features of an immature market, with weak regulations compare to developed markets in Europe and America. Investors in this type of market concentrate more on their dividend returns due to the substantial market risk and undiversified volatility, which in the long run, may have effect on the firm's stock performance. This implies that stock performance is important to both firms and investors. Therefore, the volatility of stock market share prices in Kenya motivated this study to investigate the influence of dividend policy on stock performance of banking sector firms listed in NSE. The study was informed by signaling theory and dividend irrelevance theory. The study adopted explanatory design and targeted 12 banking sector companies listed on Nairobi Security Exchange with a target population of 126 respondents; then Yamane's formula used to calculate a sample size of 96 respondents, who were sampled through stratified sampling technique and selected using simple random sampling to participate in the study. The study used structured questionnaires to collect primary data. The research instruments were pretested in a selected established firm registered in NSE using 10 respondents from the firm. Content validity was used to check instrument validity while Cronbach's alpha was used to check instrument reliability. Data collected from the field was coded, cleaned, tabulated and analyzed using both descriptive and inferential statistics with the aid of specialized Statistical Package for Social Sciences (SPSS) version 24 software. Descriptive statistics was used to compute means, percentages, frequencies, standard deviations while inferential statistics was used for variable relationships. From the values of unstandardized regression coefficients with standard errors in parenthesis, all the independent variables were significant predictors of stock performance (dependent variable). The study concluded dividend policy is a significant predictor of stock performance, thus trading firms that craft and implement viable dividend policies can boost their stock performance. The study recommended that trading companies should craft and implement viable dividend policies that will attract a positive yield on their stock performance.

Key Words: *Dividend Policy, Stock Performance, Banking Sector Firms, NSE*

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INTRODUCTION

The major fundamental goal of modern corporate entities is to maximize the value of shareholders through three major goals; the investment function, the financial decisions and the aspect of dividend policy which encompasses the amount to payout as dividends and amount to be retained (Mirza, 2014). Dividend policy is concerned with financial policies regarding paying cash dividend in the present or paying an increased dividend at a later stage. Whether to issue dividends and what amount, is determined mainly on the basis of the company's inappropriate profit (excess cash) and influenced by the company's long-term earning power. When cash surplus exists and is not needed by the firm, then management is expected to pay out some or all of those surplus earnings in the form of cash dividends or to repurchase the company's stock through a share buyback program (Pandey, 2005). If there are no NPV positive opportunities, that are projects where returns exceed the hurdle rate, and excess cash surplus is not needed, then – finance theory suggests – management should return some or all of the excess cash to shareholders as dividends. This is the general case, however there are exceptions. For example, shareholders of a growth stock expect that the company will, almost by definition, retain most of the excess earnings so as to fund future growth internally (Omran & Pointon, 2004).

According to Gul, Sajid, Razzaq, Iqbal and Khan (2012) the optimal dividend policy is the one that maximizes the company's stock price, which leads to maximization of shareholders' wealth. Whether or not dividend decisions can contribute to the value of firm is a debatable issue. Firms generally adopt dividend policies that suit the stage of life cycle they are in. For instance, high- growth firms with larger cash flows and fewer projects tend to pay more of their earnings out as dividends. The dividend policies of firms may follow several interesting patterns adding further to the complexity of such decisions (Zhou & Ruland, 2006). First, dividends tend to lag behind earnings, that is, increases in earnings are followed by increases in dividends and decreases in earnings sometimes by dividend cuts. Second, dividends are "sticky" because firms are typically reluctant to change dividends; in particular, firms avoid cutting dividends even when earnings drop. Third, dividends tend to follow a much smoother path than do earnings.

The pattern of dividend policies not only varies over time but also across countries, especially between developed, developing and emerging Capital markets. If the value of a company is the function of its dividend payments, dividend policy will affect directly the firm's cost of capital. A difficult decision for both public and private limited companies is to determine the appropriate level of dividend to be paid to shareholders, and to decide whether or not to offer non-cash alternatives such as scrip dividends according to Adediran and Alade (2013). Agrawal and Jayaraman (2004) observed that Dividend payments and leverage policy are substitute mechanism for controlling the agency cost of free cash flow hence, improves performance. If a firm's policy is to pay dividend each year end to shareholders, the level of activity in the organization will increase to obtain more income and have excess retained earnings to meet the standard set.

Stock performance is an important wheel for economic growth as there is a long-run relation between stock market performance and economic growth (Shahbazet al., 2018). Stock market performance has the direct impact in corporate finance and economic development. Thus, understanding the origins of stock market stability has long been a topic of considerable interest to both policy makers and market practitioners. For instance, stock price unpredictability is the fluctuation in the price of broad stock market indexes over a defined period Ambrosio (2007). Engle and Rangel (2008) find that high changes in stock performance have both a

short-run and long-run component, and suggest that the long-run component is related to the business cycle. Adrian and Rosenberg (2008) show that the short- and long-run components of instability in stock market performance are both priced, cross-sectional. They also relate the long-run component of instability to the business cycle.

Stock market performance is an important determinant of investment decisions in many countries. For instance, earlier research in developed countries such as Germany, United State, France and Canada indicated that higher performance of the stock markets enhances investment efficiency (Healy and Palepu, 2011; Lambert, Leuz, and Verrecchia, 2017). Coherent with this argument, Biddle and Hilary (2006) in Australia found that firms with higher stock performance reveal higher investment efficiency (stock prices changes). Thus the primary objective of financial reporting about several stocks is to provide quality stock market information to capital providers and other stakeholders to support them in making investment decision thus enhancing share price market efficiency (IASB, 2008). According to Dahmashet al. (2012) stock prices are likely response rapidly and simultaneously to any new stock market and may change frequently. In efficient stock markets it is anticipated that the price of a stock issued by a company must financial statements, historical price of stock, information published by journals and other mass media, or any report or analysis (Charles, 2012).

In Kenya, as noted by CMA (2010), Nairobi Securities Exchange (NSE) is the single major open capital market in the country. It differs from those developed markets in such characteristics on firm levels as board characteristics and size, asset structure, profitability, firm size and corporate governance standards (CMA, 2010) making it a unique context of this study. For a long time, companies at the Nairobi Securities Exchange operated without clear control and directorship structures, presenting corporate governance concerns among stakeholders because of poor stock performance of some firms listed on NSE. According to international standards, the Nairobi Securities exchange is smaller in size, has low liquidity levels and high volatility in stock performance with regards to price and returns. Over the recent years, Kenya's liquidity has been increasing with the bid ask spread decreasing and the trading volumes increasing in the last 10 years (CMA, 2015).

Further, the Nairobi Securities Exchange has experienced periods of high and low returns on shareholders' investments since it was constituted in 1954. Among other factors such as prevailing political environments in the economy, the stock market liquidity has been noted to be one of the major causes of variations in stock performance in the NSE. Even though the NSE is in general considered highly liquid market and more active in terms of trades as compared to most of the other markets in East Africa and the sub-Saharan Africa, the low level of securities market performance is still considered a huge challenge facing the Kenyan securities market with decreased level of liquidity specifically experienced in the equity and bonds secondary markets (CMA, 2015). Therefore, arising from low levels of stock market liquidity on NSE, motivated this study to investigate the influence of share earnings, liquidity, dividend policy and capital structure on stock market performance among listed firms in NSE, Kenya.

Statement of the Problem

The performance of the stock market in any country is a strong indicator of general economic performance and is an integral part of the economy of any country. With the introduction of free and open economic policies and advanced technologies, investors are finding easy access to stock markets around the world. The fact that stock market indices have become an indication of the health of the economy of a country indicates the importance of stock markets. This increasing importance of the stock market has motivated the formulation of many

theories and models to describe the performance of the stock markets (Gupta, Chevalier & Sayekt, 2008).

Despite high volatility of share price in Kenya, the results of the empirical analysis are still ambiguous due to many factors. From the literature review with scanty empirical evidence it is still not clear on the direction of the relationship between dividend policy and stock performance. Most of the studies done in Kenya have considered two variables for example Sifunjo and Mwasaru (2012) which considered only two variables, exchange rates and share prices. Ngahu (2006) on book value per share issue price and first trading day prices of IPOs at NSE, Cheluget (2008) on investor's demand for IPOs and first day performance: evidence from NSE. Due to this lack of sufficient literature and conclusive empirical evidence to explain influence of dividend policy on stock market performance at NSE remain largely unexplained, a gap that was filled by this study that endeavored to investigate influence of dividend policy on stock market performance among banking sector firms listed in Nairobi Securities Exchange, Kenya.

Objective of the study

To determine the influence of dividend policy on stock performance among banking sector firms listed in Nairobi Securities Exchange, Kenya.

Research Hypothesis

The study sought to test the following hypothesis

H_{O1}: There is no significant influence of dividend policy on stock performance among banking sector firms listed in Nairobi Securities Exchange, Kenya

LITERATURE REVIEW

Theoretical Review

The case for dividend irrelevance theory is strong in relation to dividend policy. Modigliani and Miller (M and M, 1961) advanced the dividend irrelevance theory and argued that in ideal circumstances, the level of a firm's dividends will not affect the value of the firm with shareholders being indifferent to an announcement of high or low levels of dividends (Baker & Wurgler, 2004) M and M further argued that the value of a company depends solely upon the investment opportunities available to it. They also argued that finance for investment is always available for worthwhile projects, that is, for a given set of investment opportunities, the firm can raise sufficient capital internally and externally to fund both its investment programmes and dividends. The implication of M and M (1961) proposition on managers is that they should spend more time managing the firm's assets. The residual dividend theory was advanced by Stewart Myers in1984 and further argued for the irrelevance of dividends (Njuguna & Jagongo, 2015). The essence of the theory is that the firm will only pay dividends from residual earnings, that is, from earnings left over after all suitable investment opportunities have been financed. Managers will prefer to utilize retained earnings as the primary source of investment financing before issuing debt or equity.

Modigliani – Miller theory goes a step further and illustrates the practical situations where dividends are not relevant to investors. Irrespective of whether a company pays a dividend or not, the investors are capable enough to make their own cash flows from the stocks depending on their Modigliani- Miller Theory on Dividend Policy need for the cash (Majumdar & Chhibber, 1999). If the investor needs more money than the dividend he received, he can always sell a part of his investments to make up for the difference. Likewise, if an investor has no present cash requirement, he can always reinvest the received dividend in the stock. Thus, the Modigliani – Miller theory firmly states that the dividend policy of a company has no influence on the investment decisions of the investors. This theory also believes that dividends are irrelevant by the arbitrage argument. By this logic, the dividends distribution to shareholders is offset by the external financing. Due

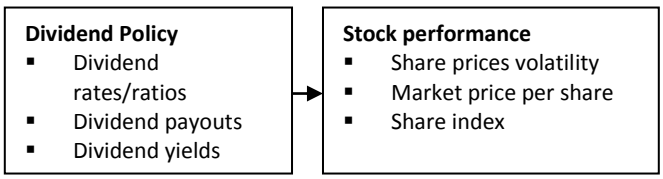
to the distribution of dividends, the price of the stock decreases and will nullify the gain made by the investors because of the dividends (La Porta et al., 2000).

Signaling Theory

Signaling theory explains why firms have an incentive to report information voluntarily to the capital market: voluntary disclosure is necessary in order for firms to compete successfully in the market for risk capital. Insiders know more about a company and its future prospects than investors do; therefore, investors will protect themselves by offering a lower price for the company (Omran and El-Galfy, 2014). However, the value of the company can be increased if the firm voluntarily reports (signals) private information about itself that is credible and reduces outsider uncertainty (Mahoney, 2012). According to signaling theory (Spence, 1973), the primary objective of corporate disclosure is to inform analysts and investors about the firm quality and value. This suggests that voluntary disclosure decisions lead to the reporting of relevant information about firm performance. Based on these theoretical suggestions, prior studies have attempted to empirically examine the relevance of corporate voluntary disclosure. Signaling theory according to Akoto and Gatsi (2010) is a theory which is built on the assumption that managers have more information than the stakeholders on the activities of the firm, and therefore managers could increase the leverage component. However, in contrast to market timing, where securities offerings are seen as an attempt to raise "cheap" capital, the signaling model assumes that financing decisions are designed basically to convey managers' confidence in the firm's future prospects to outside investors (Barclay &Smith, 2005).

The signaling theory assumes that firms with higher performance use financial information as a tool to transmit signals to the market. Signaling theory is useful for describing behavior when two parties (individuals or organizations) have access to different information. Typically, one party, the sender, must choose whether and how to communicate (or signal) that information, and the other party, the receiver, must choose how to interpret the signal (Rouf, 2015). Signaling theory is focused on information asymmetry among parties that are involved in the allocation of firm funds. Financial markets are based on contractual relationships that occur under conflicting conditions where, if one market player benefits, another loses. The signaling theory argues that the existence of information asymmetry can also be taken as a reason for good companies to use financial information to send signals to the market (Ross (1977). Information disclosed by managers to the market reduces information asymmetry and is interpreted as a good signal by the market.

Conceptual Framework



Independent Variables **Dependent Variable**

Figure 1: Conceptual Framework

Source: Author (2019)

Empirical Studies

Dividend Policy and Stock Performance

Dividend per share is defined as gross dividend divided by number of ordinary shares. It indicates the retention policy of the company as investors would always prefer higher ratio to continue to retain investment in the company (Siyanbola & Adedeji, 2014). According to Khan (2012), dividend per share is important for investors as they consider dividends not only the source of income but also a way to assess company from investment point of view and whether the company is cash generative or not and determining if a company pays more dividends than

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fewer funds available for investment in future projects. Also lenders are also interested in the amount of dividend that a company declares, as more amounts is paid as dividend means less amount would be available to the company for servicing and redemption of their claims. There are mainly two schools of thoughts that presents two different opinions about the dividend policy of a company and its impact on stock price, one school of thought followed the opinion of Miller and Modigliani (1961) concept of dividend irrelevance theory in which they explain that dividend policy does not affect the stock prices and considered dividend policy irrelevant while the second school of thought followed the point of view of Gordon (1963) and considered dividend policy relevant in relation to the value of the firm and the market price of shares (Khan, 2012). Companies also realize that investors pay close attention to their dividend returns, and that the insecurity of their investments may affect the valuation of the firm's shares in the long run (investopedia.com). This makes the volatility of stock prices as important to firms as it is to investors (Okafor & Mgbame, 2011).

Suleman, Asghar, Ali, and Hamid (2011) studied the association of dividend with share price volatility in Pakistan. They extracted data from Karachi Stock Exchange regarding five important sectors for the period of 2005 to 2009. They used multiple regressions model for their analysis. Contrary to Baskin, (1989) results, their findings showed that share price volatility has significant positive relationship with dividend yield.

Hussainey et al. (2011) examined the relationship between share price volatility and dividend in UK. They selected 123 English companies and the period of their study was from 1998 to 2007. Similar to Baskin (1989) they used multiple regression analyses for exploring the relationship of share price with dividend yield and dividend pay-out ratio.

Da, Jagannathan and Shen (2014) using Gordon growth model reinforce the ability of dividend yields to predict future stock movements while again cautioning against relying on a single factor. They also imply that dividend yield does bear the information content a position this study agrees to entirely.

From the preceding review, evidence has put much weight on using a single dividend proxy to deliver whatever each of the studies may wish to achieve, such a stance ignores the complementary nature of the variables as well as the substitution effect of each. This study employs both dividend yield and pay out in the hope that this gap was addressed.

METHODOLOGY

This study used explanatory research design. Kumar (2005), states that explanatory is used to refer to a research in which the researcher, rather than creating the treatment, examines the effect of a naturally occurring treatment after it has occurred. The target population comprises of 12 banking sector companies listed in Nairobi stock exchange Nairobi Security Exchange (NSE, 2017); where primary data was collected from 126 targeted respondents who were classified into 7 stratum; CEOs, finance officers, accountants, risk management officers, investment officers, internal auditors and marketing officers who re perceived to have valid information about stock performance. Ninety six (96) respondents formed the sample of the study using Taro Yamane's proportional sampling technique formula. Then stratified sampling technique was used to randomly pick respondents from each stratum.

Primary Data was collected using structured questionnaire. The item in the questionnaire were designed by the researcher and they were measured using 5 point liker scale (1-strongly disagree, 2-disagree, 3-undecided, 4-agree and 5 strongly agreed). Secondary sources were achieved by analyzing the content of financial reports of the 7 firms quoted in NSE. The questionnaires were self-

administered through sending hard copies of the questionnaires to the respondents and picking them later. A pilot study was conducted to determine validity and reliability of the research instruments using selected established firm registered in NSE using 10 respondents from the bank. Reliability was established using Cronbach alpha where dividend policy had an alpha value of 0.826 and stock performance value of 0.817. The researcher employed face and content method where all questions were checked for clarity of word and statements relating to study variables.

Both descriptive and inferential statistics was used to analyze data with the aid of specialized Statistical Package for Social Sciences (SPSS) version 24 software. Descriptive measures included mean, standard deviation, frequency and percentages. Inferential statistics are closely tied to the logic of hypothesis testing discussed. Inferential statistics included Pearson Correlation and multiple regression analysis. Pearson correlation assumes the data is linear, and shows the relationship/association between the dependent variable and independent variable. The output of analysis was presented using tables and models to make them reader friendly.

FINDINGS

Descriptive Statistics

This assessed the perception of a company's dividend policy and stock performance of banking sector firms listed on NSE. The perceptions were measured using Likert scale with values ranging from 5 to 1; that is; 5=Strongly Agree, 4=Agree, 3= Uncertain, 2=Disagree and 1= Strongly Disagree; and the responses were summarized in table 1.

Table 1: Descriptive Statistics; Dividend Policy and stock performance

	Frequency and Percentage (%)						
Statement	**5**	**4**	**3**	**2**	**1**	**Mean**	**Std.Dev**
1.There is a functional dividend payout policy	14(15.7)	59(66.2)	3(3.4)	8(9.0)	5 (5.6)	3.78	0.809
2.The dividend rates influence our stock market value	11(12.4)	55(61.8)	5(5.6)	11(12.4)	7(7.9)	3.58	0.806
3.The dividend yields really influence stock performance	10(11.2)	54(60.7)	4(4.5)	15(16.9)	6(6.7)	3.55	0.887
4.The dividend payout ratios affect stock market value	10(11.2)	53(59.6)	9(10.1)	10(11.2)	7(7.9)	3.55	0.986
5.Generally dividend policy really influences stock performance	15(16.9)	57(64)	4(4.5)	7(7.9)	6(6.7)	3.76	0.945
Grand mean = 3.64							

From table 1, most respondents agreed (66.2%) and strongly agreed (15.7%) that there was a functional dividend payout policy. This meant that firms with dividend payout policy are trusted by investors having hope in earnings dividends which then also attracts investors in a firm that regularly pays out dividends.

Secondly, most respondents agreed (6.18%) and strongly agreed (12.4%) that the dividend rates influenced their stock market value. This implied that firms with higher and regular dividend rates will attract high stock values and consequently high stock prices. Similarly, 60.7% and 11.2% of respondents agreed and strongly agreed respectively that the dividend yields really influence stock performance; implying that investors will trust a firm with high and regular dividend yields which was perceived to

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positively influence its share prices. Likewise, most respondents agreed and strongly agreed that the dividend payout ratios affect stock market value, implying that firms with high dividend payout ratios will boost its stock market value which subsequently will have a positive bearing on its stock performance.

Lastly, most respondents agreed (64.0%) and strongly agreed (16.9%) that generally dividend policy really influences stock performance; the grand mean = 3.64; rounded off to 4 which is agree on Likert scale. This generally means that companies with effective dividend policy would boost its stock market value and consequently boost its stock prices. This is supported by Siyanbola and Adedeji, 2014 and Khan (2012) assertions that dividend policy indicates the retention policy of the company as investors would always prefer higher ratio to continue to retain investment in the company and dividend per share is important for investors as they consider dividends not only the source of income but also a way to assess company from investment point of view and whether the company is cash generative or not and determining if a company pays more dividends than fewer funds available for investment in future projects; the lenders are also interested in the amount of dividend that a company declares so as to determine the lending ratios.

Inferential Statistics

This tested the linear influence of dividend policy on stock performance of banking sector companies listed on NSE. The results are shown in table 2.

Table 2: Direct influence of dividend policy on stock performance

Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Change Statistics				
					R Square Change	F Change	df1	df2	Sig. F Change
1	.789[a]	.623	.619	.71144	.623	143.918	1	87	.000

ANOVA[b]

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	72.844	1	72.844	143.918	.000[a]
	Residual	44.035	87	.506		
	Total	116.879	88			

Coefficients[a]

Model		Unstandardized Coefficients		Standardized Coefficients		
		B	Std. Error	Beta	t	Sig.
1	(Constant)	.573	.094		6.071	.000
	Dividend Policy	.998	.084	.789	11.997	.000

a. Dependent Variable: Stock Performance

The model summary in table 2 showed R^2 = 0.623, which implied that 62.3% variations in stock performance of banking sector companies listed Nairobi Securities Exchange was explained by dividend policy while other factors not in the conceptualized study model accounted for 37.7% variation in stock performance of banking sector companies listed on Nairobi Securities Exchange.

Further, coefficient analysis showed that there existed a significant influence of dividend policy on stock performance (β= 0.998 (0.084); *at p<.01*). This meant that a single increase in effective dividend policies by banking sector companies listed on NSE would yield 0.998-unit increase in stock performance of banking sector companies listed on Nairobi Securities Exchange. The linear regression equation model is;

(ii) $y = 0.573 + 0.998X_1$

Where;

y = stock performance

X_1 = dividend policy

Hypothesis of the study stated that there is no significant influence of dividend policy on stock performance of banking sector firms listed in Nairobi Securities Exchange. The results indicate that there exists a positive and significant influence of dividend policy on stock performance (β = 0.296 (0.102) at *p<0.05)*. The study Hypothesis was therefore rejected. The results implied that a single increase in effective dividend policies of banking sector companies listed on NSE will yield 0.296-unit increase in stock performance of banking sector companies listed on Nairobi Securities Exchange. The results are supported by Khan (2012) who asserted that dividend per share is important for investors as they consider dividends not only the source of income but also a way to assess company from investment point of view and whether the company is cash generative or not and determining if a company pays more dividends than fewer funds available for investment in future projects. Also lenders are also interested in the amount of dividend that a company declares, as more amounts is paid as dividend means less amount would be available to the company for servicing and redemption of their claims (Khan, 2012).

Further, Suleman, Asghar, Ali, and Hamid (2011) studied the association of dividend with share price volatility in Pakistan and found that share price volatility has significant positive relationship with dividend yield. Similarly, Hussainey et al. (2011) examined the relationship between share price volatility and dividend in UK and found a positive relationship between share price with dividend yield and dividend payout ratio.

SUMMARY

The general objective of the study was to determine the influence of dividend policy on stock performance among banking sector firms listed in Nairobi Securities Exchange, Kenya. The study tested null hypothesis: There is no significant influence of dividend policy on stock performance among banking sector firms listed in Nairobi Securities Exchange, Kenya. From descriptive statistics, most respondents agreed (64.0%) and strongly agreed (16.9%) that generally dividend policy really influences stock performance; the grand mean = 3.64; rounded off to 4 which is agree on Likert scale. This generally means that companies with effective dividend policy would boost its stock market value and consequently boost its stock prices. Linear regression results also showed that there exists a positive and significant influence of dividend policy on stock performance (β = 0.998 (0.084) at p<0.05). The results imply that a single increase in effective dividend policies of banking sector companies listed on NSE will yield 0.998-unit increase in stock performance of banking sector companies listed on Nairobi Securities Exchange.

CONCLUSION AND RECOMMENDATION

The study concluded that dividend policy is a significant predictor of stock performance, thus trading firms that craft and implement viable dividend policies can boost their stock performance. Generally, dividend policy really influences stock performance. This meant that companies with effective dividend policy will boost its stock market value and consequently boost its stock prices. The study recommended that trading companies should craft and implement viable dividend policies that will attract a positive yield on their stock performance

Areas of Further Studies

First a similar study can be done using longitudinal research design to assess determinants of stock performance for a period of five to ten years.

Secondly, another study can be done be done non-banking trading firms listed on NSE so as to compare results.

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